840

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Current
Policy
No. 840

Latin America's Economic Challenge: The Democratic Response

United States Department of State
Bureau of Public Affairs
Washington, D.C.

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JUN 25 1986
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Following is an address by Ambassador Alan L. Keyes, Assistant Secretary for International Organization Affairs and chairman of the U.S. delegation, before the 21st plenary of the Economic Commission for Latin America, Mexico City, Mexico, April 23, 1986.

The past 10 years have witnessed the triumph of democracy in Latin America. A decade ago, only 10 Latin American countries had freely elected governments. Today, there are 25. Currently, over 90% of the people of Latin America and the Caribbean live under democratic political systems. All over the region the people have declared their passion for liberty. They are determined to have governments that respect the inviolable dignity of the human person, governments whose form and composition are commensurate with the innate human capacity for self-government. Thanks to the rising tide of political democracy, Latin America and the Caribbean are today regions of dynamic hope, stages upon which the drama of mankind's best aspirations are each day being played out. It is a drama of pride and rising self-confidence, a drama of leaders who understand the importance of justice for all the people and of people who accept and respect the need for highly motivated leadership.

In place of the bitter resentments and antagonism that for decades have divided the governed and the governing, a spirit of reconciliation has arisen. Within and among the countries of Latin America and the Caribbean, people of different classes, backgrounds, and conditions are becoming reconciled to their dependence upon one another, reconciled to the need to respect in one another the dignity, capacity, and aspirations of their common humanity. In this reciprocal confidence between and among the people and their duly elected leaders, we can see the outline of a new social contract taking shape in countries throughout the region. It is a new contract of freedom, in which the right of the people to choose their government is respected. It is a new contract of equity, in which the incentives and rewards of leadership and labor are granted without resentment. It is a new contract of justice, in which the good of the whole community is acknowledged to be the responsibility of all and the exclusive possession of no one group, class, or division of society.

The rising tide of democratic freedom in Latin America flows toward a future of great promise. Yet in the minds of many, the prospect of that future is overshadowed by the realities of the present economic situation. Latin America may well be going through the most trying economic period in its history. The 1982–83 recession required painful adjustments. Despite these difficult efforts, economic growth remains slow. The external debt of many Latin American countries remains a serious problem.

This problem has been in part the result of inappropriate domestic economic policies, which have motivated extensive capital flight. Many observers believe that at least $100 billion has left Latin America since 1980. Much of the region's borrowing did not finance productive investment. The same policies that led to this financial hemorrhage generated the large demand for foreign credit in the first place. They included overvalued exchange rates, low domestic real interest rates, low confidence in the security of domestic investment and in the legal protection afforded to personal property, restrictions on labor market mobility, restrictions on the international flow of goods and services, the burgeoning of public sector enterprises, and overly expansive fiscal policies.

Many have expressed fears that favorable democratic trends in Latin America may be undone by instability resulting from the economic situation. These observers suggest that persistent net outflows of capital could deprive Latin American countries of desperately needed resources for investment. They argue that stagnating economies could give rise to skyrocketing unemployment, shortages of basic goods, and uncontrollable inflation. According to this view, masses of people without work or hope, their industry negated by adverse trends, their savings consumed by ever-increasing prices, could become the kindling for ugly social conflagrations.

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There is concern that, inflamed by economic deprivation, the deep divisions and rivalries between classes and groups might erupt into conflict, fueled and armed by forces unfriendly to democratic freedom. These observers believe that military dictatorships of the right or the left could stride forward, promising to mend shattered peace and order, or else realize, through grim regimentation, desperate dreams of egalitarian social progress.

The specter of such a future inspires deep anxiety in the minds of many sincere friends of democratic freedom throughout Latin America. They believe that to preserve democracy, governments must find means to resolve the current economic difficulties. My delegation believes, however, that the same democratic principles which have restored hope and energy to the politics of Latin America can bring growth and vigor to its economies. The same confident partnership between free peoples and motivated leaders can unlock the latent potential of its population. The new social contract of freedom, equity, and justice can assure the foundations of a lasting but dynamic economic equilibrium.

The New Contract of Freedom

In the economic as in the political sphere, choice is the basis of democratic freedom. Choice implies competition among alternative conceptions, products, and tastes. It implies a system in which these ingredients can interact without undue interference to determine the society's pattern of production, distribution, and consumption. Competition and a free market for economic transactions are, thus, the implied economic bases of the new contract of freedom.

The experience of many countries, both industrial and developing, has confirmed that emphasis on these institutions contributes to economic growth. Nations that have avoided policies which interfere with the market test of competition have generally enjoyed better economic performance. The competitive pressure of the market is the force that leads to greater efficiency and accelerates economic growth. The market cannot achieve this efficiency without policies that allow the price system, including appropriate exchange rates, to allocate resources efficiently. One recent study concluded that a major impediment to investment in Latin America is widespread price controls. Though often viewed as a way to protect the purchasing power of the poor, usually just the opposite occurs. Price controls inhibit investment, resulting in reduced production, shortages, and, eventually, higher prices than would have prevailed without the controls.

An unfettered price system provides the framework for rational economic choices by producers and consumers alike. To protect this framework, fiscal discipline is essential, as well as efforts to control inflation. Fiscal deficits are financed either by inflationary money creation or by heavy borrowing. A large deficit can temporarily boost the economy, but the high soon wanes, leaving only high inflation. High inflation eventually brings low growth due to massive economic disruption.

Where the framework for choice is well established, the stage is set for healthy competition. Such competition cannot take place, however, where individuals or enterprises are mere appendages of state power or where economies are walled in by protectionist measures from reciprocal interaction with the outside world. Privatization and an open trading system are the keys to economically effective competition. Privatization is a creative process designed to shift whole areas of economic activity from the politically dominated and generally unprofitable state sector to the consumer-dominated, profit-oriented private sector. It requires that governments open inefficient state monopolies to private competition. It requires, as well, relief from the crushing burden of excessive economic restrictions.

The existence of a large informal or underground economy in many, if not all, Latin American countries offers clear evidence of the inhibiting effects of artificially imposed restrictions. Without governmental limits on competitive economic activity, economies expand due to the inherent dynamism of private enterprise and entrepreneurship. In some countries, uninhibited informal sectors may account for well over half of the actual GNP [gross national product]. The aim should be to bring the entire economy into line with the dynamism of these informal sectors.

After World War II, many Latin American countries adopted an import substitution policy which led them to the establishment of a number of inefficient industries unable to compete on the world market. By contrast, the developing Asian countries emphasized export industries. Over the years, Latin America largely exhausted its prospects for import substitution while the Asian countries penetrated markets throughout the world. Asian exports boomed, enabling them to import as well, thus generating high growth. Moreover, much of their expansion was financed internally with relatively less recourse to external borrowing. Experience, therefore, shows that countries that have shifted from import substitution to more open policies have experienced better economic performance. This is particularly true for smaller countries that concentrate on a limited range of products in which they can achieve economies of scale.

Import substitution policies result in costly inefficiencies and useless, uncompetitive industries that are a net drag on the economy. They also result in higher prices for both imported and domestically produced goods, lower real incomes, and a lower standard of living for the people. The monopoly elements that are created in the process reduce production, boost prices, and make some people extremely rich at the expense of the rest.

Increased and diversified exports are of great importance to Latin America's economic future. Exclusive reliance on traditional commodity exports is unrealistic. To compete in world markets, the region's industries require the best and latest know-how, in the broadest sense. Yet these capabilities will not come in the face of restrictive import and foreign investment regimes. Unless a stable and predictable environment is created to attract investors, both foreign and domestic, competition in the international arena will be difficult. I hope that we can count on the support of your governments for the early initiation of a new, broad round of multilateral trade negotiations, which has as its purpose the enhancement of an open international trading system. The United States looks upon the countries of Latin America and the Caribbean as natural allies in the effort to break down further the barriers to exports which exist in the regimes of our trading partners.

The New Contract of Equity

The new contract of freedom promotes the scope for choice and competition essential for economic dynamism. But without a sense of equity, societies cannot achieve the stability needed to sustain this dynamism. In economics as in politics, equity is based upon mutual respect. The people must respect the need for incentives, without which eco-

nomic leadership and initiative will falter. Popular participation and popular consumption, however, are vital to the success of a modern economy. Economic leaders, therefore, must respect the right of the people to rewards commensurate with their indispensable contribution to the economy's success. The interdependence of incentives and leadership, of rewards and popular participation, is, therefore, the basis of the new contract of equity.

The new contract of equity means an end to the compulsory redistribution of wealth by the power of the state. Economics need not be a zero-sum game. Respect for equity encourages appropriate incentives for economic leadership. Entrepreneurial activity ensures increasing opportunities for participation in the economy through rewarding employment. As a result, the allocation of goods in the society results from a dynamic process, an upward spiral of incentives and opportunity, participation and reward.

Nowhere is this more clearly demonstrated than in the experiments in expanded capital ownership taking place in some parts of Latin America. Through profit-sharing in the form of stock distribution, employees in industrial and agricultural enterprises gain a stake in the success of their economic system, which in turn leads to increased productivity. Through expanded capital ownership schemes, economic leaders break down rigid patterns of economic activity which restrict ownership to a small group or class of the people. But they do so in a way that respects and strengthens the principle of ownership, of private property and individual responsibility. Instead of narrowing the economy's base of support to an unstable few or concentrating its power unproductively in the state bureaucracy, this apporach broadens the economic foundations and diffuses economic power throughout the system.

We do not mean to suggest that the expanded capital ownership approach is a universally applicable one. However, it illustrates the principles and concepts through which democracy can build a firm social foundation for economic cooperation and growth. Ownership need not be a reality confined to the wealthy few or an all-powerful state. Through the operation of democratic principles, it can become an experience universally shared and understood.

The New Contract of Justice

The principles of democracy now advancing in Latin America and the Caribbean clearly offer practical foundations for addressing the region's current economic problems. Above all, however, they offer the paradigm for economic cooperation on a democratic scale. By this measure, successful economies must transcend sharp distinctions between beneficiaries and laborers, owners and workers, leaders and common folk. As individuals, all experience the benefits. As individuals, all take responsibility for success or failure. Governments need not be all-powerful mediators among irreconcilably hostile classes or groups. Freed from their fear of one another, people can live and work together with no need of an obtrusive government power to overawe their violent inclinations. Such are the fruits and the future of democracy. Such is the meaning of the democratic contract of justice.

It is especially this aspect of the democratic revolution in Latin America which provides a principle for the relations among states in the region, and especially for the relations between them and the United States. The future of our hemisphere is a shared promise and a shared responsibility. We shall all gain or lose by the strength of our mutual trust and cooperation.

Nowhere is this more clearly seen than in our approach to the difficult problem of Latin America's debt burden. Several Latin countries have made considerable efforts in the past several years to take the necessary stabilization measures to reduce their external imbalances, improve their export capabilities, and move their fiscal positions more into balance. Continued efforts are needed, however, to reduce domestic imbalances and inflation and to put in place structural reforms to improve prospects for future growth. One of the most important developments during the past year has been the emergence of broad agreement among creditor and debtor nations that improved growth in the context of further economic adjustment in the debtor nations is essential to any resolution of the debt problem.

The "Program for Sustained Growth" put foward by [Treasury] Secretary Baker in October 1985 offers a framework for cooperative action to encourage and support debtors' efforts to improve their growth prospects. This initiative aims to encourage determined efforts by debtor countries to adopt growth-oriented macroeconomic and structural reform policies which will permit them to take full advantage of improved opportunities in global markets, to strengthen the domestic foundations for growth in the longer term, and to provide for continuing orderly servicing of their debts. Of key importance will be policies designed to enhance domestic savings, encourage increased private investment, and stimulate the return of flight capital. The repatriation of flight capital would greatly reduce the need for new external borrowing.

In the spirit of Latin America's new social contract of democracy, the United States is doing its part through stronger growth, open markets, sounder fiscal policies, and recent trends toward lower interest rates. Many Latin American governments have begun to create a more positive climate for private investment, and I believe investors will respond to these improved conditions. These governments are shifting away from an antibusiness attitude, reducing excessive control and regulation, limiting the scope of state-owned enterprises, creating tax incentives for investment, and adopting growth strategies that emphasize equity financing rather than debt accumulation. These are policies that provide the basis for a partnership of freedom, equity, and justice between governments and the private sector, between the United States and the countries of Latin America and the Caribbean. On the basis of such a partnership, we may all face the future without fear, secure in the belief that through the principles of democracy we will forge lasting solutions to today's economic challenges. ■

Published by the United States Department of State • Bureau of Public Affairs
Office of Public Communication • Editorial Division • Washington, D.C. • June 1986
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